



Director of
Central
Intelligence

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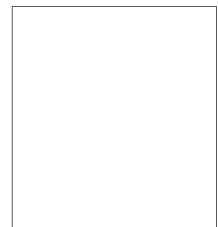
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National Intelligence Daily

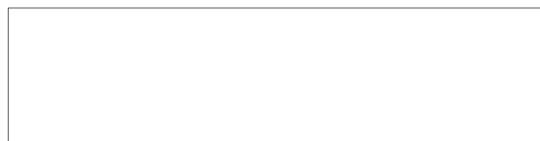
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USSR:**Tougher Line on Drugs**

Moscow, concerned that domestic drug abuse may be growing, is intensifying antinarcotics operations and offering greater cooperation with the West on drug suppression.

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Soviet officials admit publicly that narcotics consumption in the USSR has almost doubled since 1984, with 50,000 citizens currently listed as addicts. ~~(According to US officials in Leningrad, the government has distributed a million leaflets cautioning young people against experimenting with narcotics. Recent Soviet press accounts include articles on the imprisonment of Soviet officials dealing in drugs on the USSR-Afghanistan border and reports of the interdiction of narcotics in transit.~~

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The Soviet delegation at a UN narcotics conference in Vienna this summer disagreed publicly with efforts by Cuba and Nicaragua to blame the West for the drug problem. ~~(According to US officials, During a subsequent meeting the Soviets admitted that heroin was being transshipped to Western Europe through Soviet territory. They also expressed interest in Western expertise and equipment to aid control efforts. (According to the US Embassy in London, Recent Soviet press reports indicate that a joint operation between Moscow and Ottawa resulted in the seizure of 5 tons of hashish en route from Pakistan to Canada across the USSR.~~

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Comment: Moscow is anxious to project a more positive international image regarding drugs. Published Soviet figures on abusers probably still mask the extent of the problem, but admission of its existence indicates that it has attained proportions impossible to hide. The social malaise that has contributed to widespread alcoholism in the USSR is also likely to be reflected in drug abuse.

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The narcotics problem probably will prove difficult to control. Central Asian minorities have a history of narcotics use and have drug-trading expertise and cross-border ties sufficient to maintain a trafficking conduit. Extensive domestic sources of drugs such as hashish may prove even more difficult to control than imports.

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**CENTRAL
AMERICA:****Progress on Regional Parliament**

The Central American nations are close to agreement on the draft treaty for a regional parliament, but few believe it will be an effective forum. [redacted]

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[redacted] Central American Vice Presidents, Foreign Ministers, and legislators will meet in Guatemala ^{on 1 Oct} ~~tomorrow~~ to make slight revisions in the draft proposal preparatory to forwarding it to their Presidents for signature at a summit in January. ~~According to the US Embassy there,~~

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Guatemalan Vice President Carpio ~~told the Embassy last week that he~~ believes Christian Democratic parties will be able to dominate the parliament and thereby keep pressure on Nicaragua for democracy, while deterring military coups in the other countries. Carpio, who has played a key role in Guatemala's campaign to establish the parliament, claims the organization will foster political integration by choosing government representatives for regional economic institutions. [redacted]

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The Vice Presidents agreed when they last met three weeks ago that the parliament would have 110 members—20 delegates from each country as well as the president and vice president of each of the five states. Proposals for a smaller body were rejected to ensure proportional representation for all ideological positions. Carpio does not expect elections to be held for at least a year, allowing for ratification by the legislatures, the selection of candidates, and a three-month campaign. [redacted]

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Comment: Guatemala considers the parliament its contribution to peace efforts and has been pushing hard to wrap up the negotiations. Although there is not a lot on the table to fight about, the other democracies are unenthusiastic because they believe the parliament will be more a forum for debating vaguely worded, nonbinding resolutions than a mechanism for advancing democracy or resolving regional disputes. Increasing the size of the parliament probably will make it more representative but less responsive to government control. [redacted]

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The schedule Carpio outlined does not meet the Central American peace accord's specification that elections be held in the first half of 1988 and thus avoids an early test of Nicaragua's commitment to free elections. Moreover, the democracies are not likely to amend provisions that allow each country to set its electoral rules. They probably calculate that the presence of international observers—as required by the peace accord—will ensure fair balloting. [redacted]

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ARGENTINA:**Economic Malaise Deepens**

Domestic and international economic problems may force Argentina to suspend payments on its foreign debt unless creditors offer major concessions. [redacted]

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The US Embassy predicts growth of only 2 percent this year, and business leaders foresee a gloomy fourth quarter characterized by rising inflation, depressed demand, and lower real wages. The Embassy believes the trade surplus will shrink to \$1.2 billion in 1987—little more than half of last year's figure—as farm output and agricultural prices fall and imports rise. [redacted]

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[redacted] the Argentine press is speculating that Economy Minister Sourrouille will ask for a \$1 billion bridge loan during his current visit to Washington. [redacted]

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Under the commercial bank accord signed last month, Buenos Aires can draw \$750 million next month but, because it is out of compliance with its IMF agreement, it will need a waiver or a renegotiation of IMF goals to obtain a second \$750 million tranche. Although Argentina is maintaining a nonconfrontational approach to debt issues, Sourrouille and Foreign Minister Caputo intend to press for new solutions to the problem. They want to reduce interest payments by nearly half to \$2.5 billion yearly [redacted]

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Comment: Despite President Alfonsin's generally moderate stance on the debt, a foreign exchange squeeze may force Buenos Aires to suspend interest payments by early next year. Sourrouille is aware that the international financial community is likely to reject his suggestion that the discounted value of debt instruments be used as the basis for interest computation. He probably hopes that raising the specter of radical action will at least press creditors to help Buenos Aires out of its financial crunch through traditional means like an IMF waiver or a bridge loan. [redacted]

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CHILE:

Pinochet on Offensive

President Pinochet's forceful efforts to promote his candidacy for the presidential plebiscite in 1989 appear to be making headway with his Military Junta despite his sagging popular standing.

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Pinochet has been campaigning aggressively for the nomination even though he has not officially announced his candidacy. He portrays himself in interviews and numerous public appearances as a bulwark against Communism and the only alternative to political chaos.

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Public opinion polls demonstrate that Pinochet's popularity remains low despite these efforts. Two recent surveys showed only 12 and 22 percent of the respondents voting for the President.

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*Gorbachev during meeting with
French officials, 29 September.*

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USSR: Gorbachev May Have Been Ill

General Secretary Gorbachev received a group of senior French officials yesterday—his first public appearance since 7 August. According to reporters who were present, Gorbachev quipped that he had earned his monthlong vacation and made light of rumors of his illness. [REDACTED]

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Comment: In the television coverage Gorbachev appeared tanned but somewhat thinner and not well rested. [REDACTED]

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USSR: Midyear Trade Results

Recently released trade data indicate the USSR recorded a \$1.2 billion hard currency trade surplus during the first half of this year, as contrasted with a \$1 billion deficit during the same period last year. Hard currency exports climbed 9 percent, to \$13 billion, largely because of an estimated 25-percent increase in the volume of oil exports. Imports dropped 8 percent, to \$11.8 billion, because of a lower grain import bill and cutbacks in purchases of machinery and equipment, steel, and other industrial products. [REDACTED]

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Comment: Improved oil revenues will bring hard currency export earnings to their highest level in two years but still below the levels achieved during 1982-84. So far this year, Moscow has not resorted to the increased borrowing and gold sales used over the past two years to help offset declining oil revenues. Barring major problems with the Soviet grain harvest, Moscow is likely to continue its tight rein on imports for the remainder of this year. Confusion and inactivity resulting from this year's reorganization of the Soviet foreign trade apparatus may have helped reduce imports. [REDACTED]

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Consequences of Leaving the Commonwealth

Fiji faces possible serious political and economic repercussions in withdrawing from the Commonwealth, an issue likely to figure in discussions at the Commonwealth heads-of-state summit opening on 13 October in Canada.

- Suva could lose as much as \$9 million annually in foreign aid from Commonwealth members.
- Markets in the UK, Australia, and New Zealand for sugar, Fiji's major foreign exchange earner, may also be at risk.
- Fiji would lose an experienced judiciary that is part of the Commonwealth and the politically neutral advice of the Governor General.
- India would be likely to veto any Fijian petition to return to the Commonwealth because of Fiji's racial discrimination against ethnic Indians.

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Fiji: Coup Leader Declares Republic

Coup leader Lieutenant Colonel Rabuka yesterday declared Fiji will be a republic, thereby suspending the constitution and effectively severing links to the British Commonwealth. Although the Governor General Ganilau has refused to resign, Rabuka nonetheless reportedly will establish an interim military council that will include some prominent civilians. According to press reports, the UK's review of the \$1.6 million in annual aid it provides Fiji has prompted a Libyan offer to make up any shortfall. Australia and New Zealand are also cutting off assistance, and their labor unions have promised to do what they can to disrupt trade with Fiji.

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Comment: The economic repercussions of withdrawal from the Commonwealth are not likely to deter Rabuka from his immediate goal of ensuring the political dominance of native Fijians. He and his new government are sure to exclude Indians rather than risk losing the support of Fiji's traditional Council of Chiefs and the growing Taukei Movement, a radical group that claims to represent 97 percent of native Fijians.

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PAKISTAN-SAUDI ARABIA: Pakistani Troops May Leave

Pakistan and Saudi Arabia apparently are preparing for the withdrawal of some 8,000 Pakistani combat troops from the Kingdom, including air defense units from the Eastern Province.

that negotiations are also under way on the status of several thousand Pakistani military advisers and technicians. The Saudis have begun preparations to store the equipment used by the Pakistanis and are recruiting additional Saudi troops to soften the impact of losing the Kingdom's only fully manned combat brigade. Riyadh has concluded agreements with Morocco and Bangladesh to send troops if Saudi Arabia is directly threatened.

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Comment: If the troops are withdrawn—probably for financial reasons—Saudi Arabia would lose its best armored brigade and a significant part of the army's combat strength, as well as experienced air defense crews. Riyadh has wanted to replace the Pakistanis since at least 1985 but might still decide to extend the contract, especially if there is another sharp rise in tension between Saudi Arabia and Iran like the one that followed the Mecca riots this summer. Nearly all Pakistani troops, however, currently are under orders not to fight the Iranians.

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Insurgent Attacks Near Oil Facilities

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ECUADOR: Colombian Guerrillas Threaten Oil Facilities

Incursions by Colombian insurgents have caused concern about the security of Ecuador's major oil facilities. Guerrillas attacked an Ecuadorean military outpost last week and ambushed a police unit that was investigating a series of recent assaults on employees and vehicles of a US-Ecuadorean oil consortium, according to the US Embassy in Quito. The US firm is reevaluating its security procedures, and some oil crews reportedly are refusing to work in isolated areas.

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Comment: Local press reports blame the Revolutionary Armed Forces of Colombia, but the attacks may be the work of M-19, which has had close ties to Ecuador's Alfaro Vive terrorist group. Colombian rebels have previously targeted Ecuadorean military personnel, but harassment of oil operators in Ecuador is unprecedented. Increased guerrilla activity may put US personnel at risk and disrupt Ecuador's oil production, only recently restored after the earthquake damage in March.

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PERU: Bank Nationalization Bill Passes

The Peruvian Senate has approved President Garcia's controversial bank nationalization scheme, clearing the way for it to become law. The measure will nationalize Peru's remaining large private banks, insurance companies, and financial houses but will not affect foreign banks.

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Comment: The bank nationalization will improve Lima's ability to oversee foreign exchange movements and to finance priority economic projects but will probably further reduce investor confidence, depressing savings and private investment. The measure has already generated fear among businessmen that more nationalizations and interventions will occur. In an apparent attempt to regain private-sector support, Garcia has named industrialist Alberto Vera La Rosa, a ruling-party activist, as Industry Minister, but business response has been lukewarm. If Garcia continues to antagonize the private sector, reinvestment of profits will fall off, and capital flight is likely to accelerate.

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In Brief

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Middle East

— Press reports **Libyan** leader Qadhafi to visit **Tunisia, Algeria** next week . . . likely to discuss joining Algeria's Tripartite Pact with Tunisia and **Mauritania** . . . his first visit to Tunis since it severed relations in 1985.

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— **Egypt** has arrested suspected members of "Egypt's Revolution," group behind attacks on US, Israeli diplomats . . . claims to defend late President Nasir's revolution

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Americas

Resignation of **Colombian** Justice Minister prompted by allegations of fraud in old customs case . . . third time post vacated in past year . . . further complicates efforts to work out process for extradition of drug traffickers to US.

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Key Chinese Industrial Reforms

Enterprise Management

Status: Beijing is implementing "enterprise responsibility systems" in which factories are granted operational autonomy but are held responsible for their own profits and losses. These have been established in only about half of the state enterprises. But factories now retain a larger share of revenues, have greater discretion over how they are used, and can market overquota production at "negotiated" above-plan prices.

Problems: Debate continues over the role of party secretaries in factories and how to prohibit excessive investment and wage hikes.

Price

Status: Many prices are little changed from the 1950s. But in the past three years, Beijing has decontrolled prices of nonstaples, such as vegetables and meat; some durable goods, including bicycles and refrigerators; and minor commodities.

Problems: Leaders are concerned that price reforms, which have contributed to bouts of inflation, may stir popular discontent. They differ over the use of administrative price adjustments or relaxation of state controls to affect price reform.

Labor

Status: Beijing plans to boost labor productivity by rewarding initiative with higher wages and by allowing workers increased say in job placement. Last fall, Beijing established guidelines for hiring new workers under fixed-term contracts that, if followed, would end lifetime job guarantees for employees in state enterprises. Most managers, however, are still unable to fire unproductive workers.

Problems: Large state enterprises are entirely responsible for housing, education, and health needs of their workers. Because local authorities object to bearing these costs if workers are laid off, Beijing continues to guarantee full employment.

Bankruptcy

Status: Reform leaders want to increase productivity and financial accountability for state enterprises. Last December, Beijing approved trial bankruptcy regulations, but the implementation has been blocked by political infighting.

Problems: Party hardliners believe these reforms are inconsistent with socialism. Others argue that managers should not be held accountable for losses as long as the price system is irrational and factory decision making is subject to bureaucratic interference.

Ownership

Status: Last year, Beijing conducted limited experiments with leasing small factories to individuals and allowed a few enterprises to issue shares to their workers.

Problems: Conservatives strongly oppose allowing state enterprises to issue shares to workers and believe that private enterprise should be strictly limited.

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Special Analysis**CHINA:****Reforms at Critical Juncture**

Deng Xiaoping and Acting General Secretary Zhao Ziyang have publicly asserted that Beijing will quicken the pace of economic reforms after China's 13th Party Congress, which convenes on 25 October. Because of leadership squabbling and an overheated economy, however, price reform and some key market-oriented policies are likely to remain stalled. Senior reform-minded Chinese officials fear that, unless Beijing can soon settle disagreements over reform goals and strategy, economic problems will intensify and popular support for reforms will erode.

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Disagreement over economic policy has been intense since the ouster of Hu Yaobang as party General Secretary in January. The more traditionalist party officials have attacked a number of reforms as "capitalist," including the reduction of central planning, the diminished role of party secretaries in state enterprises, and the leasing of small factories to individuals. These more orthodox officials have also taken advantage of rising inflation and a growing government budget deficit to criticize reformers for economic mismanagement—arguing that tighter central controls are required to combat such dislocations.

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Consequences of Uncertain Leadership

Because of strong inflationary pressure and political opposition, reform leaders have had to delay market-oriented policies, including price reform and bankruptcy legislation. This, in turn, has frustrated efforts to enforce financial accountability by state enterprises, and managers can still increase investment spending and wages without corresponding increases in productivity, which adds to inflation.

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As a compromise, reform leaders have chosen a lowest-common-denominator policy that forces state enterprises to sign performance contracts with upper level economic bureaucracies. Some reformist officials, however, fear this may strengthen the heavy industry ministries that oppose market competition.

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Uncertain economic leadership also has hampered reformers from using monetary and fiscal policies to ease inflationary pressures. Beijing has been unable, for example, to stop spending by local governments on low-priority construction projects, such as hotels and municipal halls.

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In addition, branches of China's central bank are ignoring directives to limit credit and continue to fund whatever projects local officials want; previous reforms gave local governments a greater share of tax revenues, making them less dependent on funds from central coffers. Leaders who are counting on the support of local officials at the party congress have rejected proposals to restrict provincial control over bank loans and taxes. ~~According to the US Embassy~~ Beijing, therefore, has been forced to reimpose price controls on some products and tighten restrictions on how state enterprises can use their retained earnings.

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Outlook

Workers still strongly support reform because living standards have risen rapidly over the past few years. ~~According to the Embassy~~ Senior Chinese economists nonetheless fear that support will erode unless Beijing can check inflation and corruption. Some Chinese officials, by exploiting loopholes in reform policies, for example, have used their connections to purchase goods at low government-set prices and resell them at much higher market prices. Public cynicism reportedly has begun to grow because many of the people involved are the children of senior officials.

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Despite these problems, Deng, Zhao, and other reform leaders remain firmly committed to using market mechanisms to drive China's modernization. Recently they have claimed that the party congress will approve new guidelines sanctioning market-oriented policies and that Beijing will hasten implementation of reforms later this year. Despite the upbeat rhetoric, a cautious agenda for next year may already have been set. Vice Premier Yao Yilin, a senior spokesman on economic policy, argued in a major speech last week that Beijing must implement an austerity program for several years and focus reform on improving enterprise operations—such as expanding the use of enterprise contracts.

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Decisions by the party congress thus will do little to reduce the degree of contention over economic policy. By treating the symptoms of China's economic problems rather than the disease—lack of accountability to market forces—Beijing probably has delayed reaching the point when it will have adequate monetary and fiscal tools to ease inflationary pressures generated by reduced central planning.

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